Perspectives

The Dollar In Historical Perspective

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The financial press has remained preoccupied with the prospects for a continued decline for the dollar. When the dollar's condition makes it to the front page of popular magazines, as it has recently, some might argue it is time to reverse positions. Rather than attempt to make a call on whether or not the dollar's downtrend will continue, or whether a bull market is beginning, we would like to share with you our conclusions from a recent study we completed: "The Dollar in Historical Perspective." This study, available upon request, outlines some of the themes investors should consider to help them determine if we are in either a dollar bull, or bear phase. If you are interested in obtaining a copy of our complete study, please contact Nelly Xavier by email - xavier@samsonca.com; or by telephone - (212) 300-1637.

Our study focuses on long-term trends and as a result we examined the major moves that have occurred in the dollar over nearly 40 years.

Since 1968, the dollar has moved in 4 bear phases and 3 bull phases:

- shortest phase was just under 3 years
- longest phase was over 9 years

These phases are influenced by a combination of:

- Macroeconomics
- Domestic U.S. Politics
- Geopolitics

While each period has its own particular characteristics, several generalizations can be made:

- **Strong Dollar Periods**: The dollar rallies an average of 47% during periods when stocks are rising, P/E's are expanding, real interest rates are high, and commodities are falling. Typically, the domestic economy is healthy, political and social barometers are healthy, and the nation is secure and at peace.

- **Weak Dollar Periods**: The dollar falls an average of 30% during periods when stock rallies are muted and P/E's are contracting, real interest rates are low, and commodities (as well as inflation) are rising. Often, the domestic economy is challenged by domestic political and social turbulence, usually influenced by the forces unleashed by a major war. International monetary regime changes are an important aspect of these periods. These monetary regime changes may be the results of unilateral national decisions (President Nixon's decision to end Bretton Woods), international financial diplomacy (like the Plaza and Louvre Accords), or the creation of a new currency (the Euro).

In order to determine a view for the future direction of the dollar, history teaches us we should seek to develop informed views on whether or not the years ahead will be characterized by:

- War or peace
- Commodity bull or bear markets
- Inflation or disinflation
- Higher or lower real rates
- P/E expansion or contraction
- Monetary regime change

While an analysis of the investment themes noted above can help an investor determine whether or not they have a bullish or bearish outlook for the dollar, another challenge is to determine how much non-dollar exposure an investor should consider. Our recent commentary, "What the Bank of China Can Teach Us about Investing in Foreign Currencies", noted that absolute return oriented investors can benefit from a modest amount of currency exposure to promote better diversification in their overall asset allocation strategy. While currencies can be volatile, they generally move in ways contrary to other major asset classes and in judicious amounts can help to reduce the overall volatility of an investor's portfolio. Yet if an investor has a large number of overseas liabilities, or makes a considerable portion of their purchases from overseas, a non dollar allocation should be considered as part of a purchasing power protection plan that can maintain the investor's buying power if the dollar declines.

Our scorecard below, summarizes key features of these major dollar moves and how various related asset classes such as commodities and the price return of stocks, performed. If you have any questions, please do not hesitate to call us.

								Average	
	Jan-68 to Jun-73	Jul-73 to Apr-76	May-76 to May-80	Jun-80 to Jan-85	Feb-85 to Jul-92	Aug-92 to Dec-01	Jan-02 to Aug-06	Strong $ Periods	Weak $ Periods
DXY (U.S. Dollar) Return	-23%	14%	-20%	79%	-49%	48%	-29%	47%	-30%
Annualized Return	-4%	5%	-5%	17%	-7%	5%	-6%	9%	-5%
Period Characteristics									
Domestic Soc/Pol Turmoil	x	x	x	-	-	-	x	-	x
Monetary Regime Change	x	-	-	-	x	-	x	-	x
Commodity Shock	oil spike	-	oil spike	-	-	-	oil spike	-	oil spike
Major War	x	-	-	-	x	-	x	-	x
Period Data: Inflation, Real Rates, Commodities									
CPI (Consumer Price Index)	4.64	9.21	8.58	6.84	3.89	2.64	2.64	4.90	4.70
PPI (Producer Price Index) A	3.60	11.86	8.22	5.34	2.24	1.51	2.73	4.30	3.84
Real 6 Month Yield	1.00	-2.23	-0.79	3.90	2.66	2.00	-0.24	1.81	0.94
Real 10 Year Yield	1.82	-1.56	0.05	5.65	4.56	3.39	1.71	3.18	2.40
Crude Oil Return	N/A	N/A	167%	13%	-25%	-9%	270%	37%	112%
Annualized Return	N/A	N/A	41%	3%	-3%	-1%	56%	13%	25%
CRB (Commodity Index) Ret	76%	-5%	29%	-14%	-15%	-5%	63%	-8%	39%
Annualized Return	14%	-2%	7%	-3%	-2%	-1%	13%	-2%	8%
GOLDS Cmdty (Gold) Returr	241%	7%	327%	-53%	24%	-18%	115%	-22%	177%
Annualized Return	44%	2%	80%	-11%	3%	-2%	24%	-4%	38%
Period Data: Equity Returns									
USSPX (S&P 500) Return	12%	-6%	11%	57%	134%	177%	15%	76%	43%
Annualized Return	2%	-2%	3%	12%	18%	19%	2%	10%	6%

February 15, 2007

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Sources: Bloomberg®, Energy Information Administration, Samson

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